Nos. 82-1453 and 82-1509

In the Supreme Court of the United States

OCTOBER TERM, 1982

ERNEST BADARACCO SR., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

DELEET MERCHANDISING CORP., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENTS

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QUESTION PRESENTED

Section 6501(a) of the Internal Revenue Code of 1954 (26 U.S.C.) provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * *." Section 6501(c)(1) sets forth an exception for false or fraudulent returns, providing that in such cases, "the tax may be assessed * * * at any time."

The question presented is whether the statutory exception prescribing that no period of limitations is applicable to fraudulent returns requires that where a fraudulent return is filed in the first instance, the subsequent filing of an amended nonfraudulent return does not commence the running of the three-year statute of limitations.

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OPINIONS BELOW

The consolidated opinion of the court of appeals (82-1453 Pet. App. 4a-20a; 82-1509 Pet. App. 1a-17a) is reported at 693 F.2d 298. The opinion of the Tax Court in No. 82-1453 (Pet. App. 21a-27a) is not reported. The opinion of the district court in No. 82-1509 (Pet. App. 1d-5d) is reported at 535 F. Supp. 402.

JURISDICTION

The judgment of the court of appeals (82-1453 Pet. App. 2a-3a; 82-1509 Pet. App. 1b-2b) was entered on November 29, 1982. Petitions for rehearing (82-1453 Pet. App. 1a; 82-1509 Pet. App. 1c-2c) were denied on December 20 and December 23, 1982. The petitions for a writ of certiorari were filed on February 24, 1983 (No. 82-1453) and March 8, 1983 (No. 82-1509), respectively. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1.a. *No. 82-1453.* Petitioners Ernest Badaracco, Sr., and Ernest Badaracco, Jr.,[1] were partners in an electrical contracting business. For each of the years 1965 through 1969, they filed individual and partnership returns that fraudulently understated their partnership income. On August 17, 1971, after federal grand juries had subpoenaed the partnership's books and records, petitioners filed nonfraudulent amended returns for the years in question. Petitioners were thereafter indicted on 15 counts for filing false and fraudulent income and partnership tax returns in violation of 26 U.S.C. 7206(1). They each entered a plea of guilty to the charge of filing a false and fraudulent partnership return for 1967, and the district court entered a judgment of conviction on June 6, 1973.[2] *United States* v. *Badaracco*, No. 766-71 (N.J. Crim.) (82-1453 Pet. App. 6a-7a, 23a-24a).

On November 21, 1977, the Commissioner of Internal Revenue issued notices of deficiency for the years in question, asserting liability for additions to tax under Section

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[1]Their wives, Rose Badaracco and Barbara Badaracco, are parties to this action only because they filed joint federal income tax returns for the years in issue with their respective husbands.

[2]The remaining counts of the indictment were dismissed.

6653(b) of the Internal Revenue Code of 1954 (26 U.S.C.), on account of fraud. In these proceedings brought in the Tax Court for a redetermination of the deficiencies, petitioners stipulated that the underpayments of tax on their original income tax returns were due to fraud. They contended, however, that assessments of the deficiencies was nevertheless barred by the statute of limitations under Section 6501(a) of the 1954 Code because the deficiency notices were not issued within three years after the filing of their amended returns. The Tax Court, following its decision in *Klemp* v. *Commissioner*, 77 T.C. 201 (1981), appeal pending, No. 81-7744 (9th Cir.), and the Tenth Circuit's decision in *Dowell* v. *Commissioner*, 614 F.2d 1263 (1980), upheld petitioner's position that the assessments were time barred (82-1453 Pet. App. 7a, 24a-27a).

b. *No. 82-1509.* Petitioner Deleet Merchandising Corp. filed timely corporate income tax returns for 1967 and 1968, but failed to report certain receipts for those years. It thereafter filed amended returns disclosing the unreported receipts on August 9, 1973. Following lengthy criminal and civil investigations, the Commissioner issued a notice of deficiency to Deleet on December 14, 1979, asserting deficiencies in tax and additions to tax for fraud under Section 6653(b) for both years. After paying the disputed amounts, Deleet brought this refund suit in the United States District Court for the District of New Jersey. In its motion for summary judgment, Deleet asserted that, even if the original returns had been fraudulent, the deficiencies and penalties could not be assessed more than three years after the filing of the amended returns. The district court, likewise relying on *Dowell* v. *Commissioner*, *supra*, and *Klemp* v. *Commissioner*, *supra*, granted summary judgment in favor of Deleet (82-1509 Pet. App. 1d-5d).

2. The court of appeals reversed in both cases, with one judge dissenting (82-1453 Pet. App. 4a-20a; 82-1509 Pet. App. 1a-17a). The court concluded that the terms of Section 6501(c)(1) permit the Commissioner "[i]n the case of a false or fraudulent return with the intent to evade tax" to assess the tax or proceed in court without an assessment "at any time." In the court's view, nothing on the face of the statute, its legislative history, or the regulations indicates that taxpayers who had filed fraudulent returns could thereafter claim the benefit of the general three-year statute of limitations by filing nonfraudulent amended returns. The court also noted that the three-year period was inadequate to permit the Commissioner to meet his dual responsibility of proceeding in fraud cases both criminally and civilly (82-1453 Pet. App. 12a-13a; 82-1509 Pet. App. 9a-10a).

DISCUSSION

The court of appeals correctly held that the filing of a nonfraudulent amended return does not start the running of the ordinary three-year statute of limitations under Section 6501(a) of the 1954 Code where a fraudulent return for the year in question was filed in the first instance.

1. Section 6501(a) of the Internal Revenue Code of 1954 (26 U.S.C.) provides that "[e]xcept as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) * * *." Among the exceptions to that general rule is that set forth in Section 6501(c)(1), which provides that "[i]n the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed * * * at any time."

It has long been recognized that statutes of limitations with respect to the assessment and collection of taxes are to be narrowly construed. See, *e.g.*, *Bowers* v. *New York &*

Albany Lighterage Co., 273 U.S. 346, 349 (1927); *Lucia* v. *United States*, 474 F.2d 565, 570 (5th Cir. 1973); *McDonald* v. *United States*, 315 F.2d 796, 801 (6th Cir. 1963). Thus, a statute of limitations will not be presumed to apply in the absence of clear congressional direction, and may not be extended beyond its clear language. *McDonald* v. *United States*, *supra*. Moreover, it is a basic principle of statutory construction that a specific statute controls over a general provision. *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 761 (1961).

The exception to the general three-year period of limitations provided by Section 6501(c)(1) applies "[i]n the case of a false or fraudulent return with the intent to evade tax." It is unqualified on its face. Petitioners in *Badaracco* admittedly filed such false and fraudulent returns for the years there in question. Likewise, petitioner in *Deleet* was required to assume, for purposes of its motion for summary judgment, that its original returns for 1967 and 1968 were fraudulent. These cases remained "case[s] of a false or fraudulent return" notwithstanding the subsequent filing of nonfraudulent amended returns. See *George M. Still, Inc.* v. *Commissioner*, 19 T.C. 1072 (1953), aff'd, 218 F.2d 639 (2d Cir. 1955); *Plunkett* v. *Commissioner*, 465 F.2d 299, 303 (7th Cir. 1972). Nothing in the statute or its legislative history supports petitioners' contentions that the filing of a nonfraudulent amended return after the filing of a fraudulent original return starts the normal three-year period of limitations in Section 6501(a). Rather, it is clear under Section 6501(c)(1) that "if a return be fraudulent in any respect with intent to evade a tax, it deprives the taxpayer of the bar of the statute for that year." *Lowy* v. *Commissioner*, 288 F.2d 517, 520 (2d Cir. 1961), cert. denied, 368 U.S. 984 (1962).

Indeed, not only is there no reference in the language of Section 6501(a) or (c)(1) to the subsequent filing of

amended returns, but there is no statutory authority anywhere in the Internal Revenue Code for the filing of such returns.[3] Thus, as this Court recently pointed out in *Hillsboro National Bank* v. *Commissioner*, No. 81-485 (Mar. 7, 1983), slip op. 8 n 10, "it is settled that the acceptance of * * * [an amended] return * * * after the date for filing a return is not covered by statute but within the discretion of the Commissioner." See, *e.g.*, *Koch* v. *Alexander*, 561 F.2d 1115, 1117 (4th Cir. 1977); *Miskovsky* v. *United States*, 414 F.2d 954, 955 (3d Cir. 1969)."[4]

Moreover, the courts have consistently held in other contexts that the filing of amended returns has no bearing on the operation of the statute of limitations. Thus, in *Zellerbach Paper Co.* v. *Helvering*, 293 U.S. 172, 180 (1934) and *National Paper Products Co.* v. *Helvering*, 293 U.S. 183 (1934), this Court held that the Commissioner could not rely on the filing of an amended or supplemental return as a basis for extending the statutory period for assessment and collection. Likewise, in *Goldring* v. *Commissioner*, 20 T.C. 79 (1953) and *Houston* v. *Commissioner*, 38 T.C. 486 (1962), the Tax Court held that, where

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[3]Section 6213(g)(1) of the 1954 Code defines the term "return," for the limited purpose of the summary assessment procedures applicable where an underpayment is based on "mathematical or clerical errors appearing on the return" (see Section 6213(b)), as including "any return, statement, schedule, or list, and any amendment or supplement thereto" (26 U.S.C. (Supp. V) 6213(g)(1)). But even the dissenting judge below acknowledged (82-1453 Pet. App. 16a-17a n.3; 82-1509 Pet. App. 13a-14a n.3) that this provision was adopted solely to insure that all supporting schedules on file be examined by the Commissioner before determining that there is an underpayment based on such a mathematical or clerical error. Hence, Section 6213(g)(1) has no bearing on the question presented by the petitions.

[4]It is undisputed that the amended returns in each of these cases were filed long after the expiration of the time for filing the original return. See 82-1453 Pet. App. 6a-7a; 82-1509 Pet. App. 4a.

the filing of a return with an understatement in gross income in excess of 25% activated the extended limitations period under the 1939 Code (26 U.S.C. (1940 ed.) 275(c)) predecessor of Section 6501(e) of the 1954 Code, later amended returns reducing the understatement below 25% could have no effect on the extended assessment period. Accord: *Foster* v. *Commissioner*, 45 B.T.A. 126 (1941), aff'd, 131 F.2d 405 (5th Cir. 1942). See also *Kaltreider Construction, Inc.* v. *United States*, 303 F.2d 366, 368 (3d Cir.), cert. denied, 371 U.S. 877 (1962); *National Refining Co.* v. *Commissioner*, 1 B.T.A. 236 (1924).

In sum, once petitioners filed fraudulent original returns, they plainly lost any benefit of the statute of limitations for the years in question. To conclude otherwise would ignore the plain language of the statute itself. Thus, the court of appeals correctly held that Section 6501(c)(1) continues to apply in these circumstances. Accord, *Nesmith* v. *Commissioner*, 699 F.2d 712 (5th Cir. 1983).

2. The court below acknowledged (82-1453 Pet. App. 8a-10a; 82-1509 Pet. App. 5a-7a) (as did the Fifth Circuit in *Nesmith, supra*) that its ruling conflicted with *Dowell* v. *Commissioner*, 614 F.2d 1263 (10th Cir. 1980), and the cases that have followed it (*e.g., Britton* v. *United States*, 532 F. Supp. 275 (D. Vt. 1981), aff'd, 697 F.2d 288 (2d Cir. 1982) (table) and *Klemp* v. *Commissioner*, 77 T.C. 201 (1981), appeal pending, No. 81-7744 (9th Cir.). In *Dowell*, the court placed primary reliance on the Tax Court's decision in *Bennett* v. *Commissioner*, 30 T.C. 114 (1958), which involved the 1939 Code predecessor of Section 6501(c)(3), allowing assessment at any time in the case of a "failure to file a return." The Tax Court in *Bennett* held that the filing of a late *original* return started the running of the ordinary three-year period of limitations. As the Tax Court noted in its decision in *Dowell* v. *Commissioner*, 68 T.C. 646, 650-651 (1977), rev'd, 614 F.2d 1263 (10th Cir. 1980), *Bennett* is

inapposite. Once the delinquent returns were filed in *Bennett*, it was no longer strictly a case of a "failure to file a return," but only a case of a failure to file a *timely* return. Here, the original returns filed by petitioners were a "case of a false or fraudulent return." That conclusion stands despite the fact that they untimely disclosed the fraudulent omissions on later-filed amended returns.[5]

Moreover, while the late original returns in *Bennett* were unquestionably "the return[s]" for the years there in question, the amended returns filed in the instant cases cannot be considered as "the return[s]" for the years here in question within the meaning of Section 6501(a) (cf. *National Refining Co.* v. *Commissioner, supra*). Thus, they could not have any independent significance for the purposes of that provision even if the provisions of Section 6501(c)(1) were disregarded.[6]

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[5]Indeed, in revising these limitations provisions when the 1954 Code was adopted, Congress acted to remove any ambiguity that might be thought to inhere in the 1939 Code provisions (which were later before the Tax Court in *Bennett*) by specifically providing in Section 6501(a) that the three-year period, where applicable, begins to run on the date "the return was filed (whether or not such return was filed on or after the date prescribed) * * *." No similar provision was adopted with respect to the effect of filing amended returns after the filing of false or fraudulent original returns. Thus, as the court below concluded (82-1453 Pet. App. 10a n.6; 82-1509 Pet. App. 7a n.6), Congress did, in fact, provide a clear indication that it did not intend that the two situations would be entitled to precisely the same treatment under these provisions.

[6]The court in *Dowell* reasoned that the original fraudulent Forms 1040 filed in that case were not "returns" at all within the meaning of these provisions and that the amended returns were, therefore, the only "returns" filed by that taxpayer for the years in question. 614 F.2d at 1265. That analysis, however, is based on a misreading of this Court's opinion in *Zellerbach Paper Co.* v. *Helvering, supra*. After the taxpayer in *Zellerbach* had filed original returns for the periods there in question, certain changes were made in the applicable law, and a Treasury Regulation was adopted requiring the filing of amended or supplemental returns if additional taxes were owing as a result of the changes. Although the taxpayer failed to file such an amended return,

Moreover, the court below noted (82-1453 Pet. App. 12a-13a; 82-1509 Pet. App. 9a-10a), that there are, in fact, substantial reasons why Congress could conclude that the imposition of a three-year limitations period on assessment in such cases would be inadequate to allow the Commissioner to fulfill his obligation to enforce both the civil and criminal provisions of the Internal Revenue Code. In addition to other factors supporting the deferral of civil assessment pending the completion of related fraud investigations,[7] the Internal Revenue Service loses its entitlement to

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the additional liability in its case could have been computed on the basis of the information shown on its original returns. This Court concluded that, whether or not an amended return had been filed, the Commissioner remained subject to the ordinary assessment period running from the date the original return for each year was filed. In so ruling, the Court noted that "[p]erfect accuracy or completeness is not necessary to rescue a return from nullity, if it *purports* to be a return, is *sworn to* as such * * * and *evinces* an honest and genuine endeavor to satisfy the law" and that "the limitation shall run from the original return when there is nothing *on the face of that return* to indicate that the liability reported is less than owing." 293 U.S. at 180, 182 (emphasis added; footnote omitted).

Contrary to the Tenth Circuit's analysis, the *Zellerbach* decision does not support its conclusion that a return that *purports* to be a complete and accurate return, but which is nonetheless false or fraudulent, is a mere "nullity" for statute of limitations purposes. It could scarcely be doubted that such "returns" are precisely what Congress had in mind in enacting the provisions of Section 6501(c)(1). Presumably it used the term "the return" in Section 6501(a) with the same understanding. Indeed, if fraudulent Forms 1040 were not "returns" for these purposes, Section 6501(c)(1) would be not only superfluous, but also a contradiction of terms.

[7]It has long been the policy of the Internal Revenue Service to defer the assessment of civil liability, where possible, in such cases. See Policy Statement P-4-84, 1 Internal Revenue Manual—Administration (CCH) para. 1218, at 1303-78 (Dec. 1980). The wisdom of that policy, in light of the potential for interference in the orderly prosecution of criminal cases if civil suits could be simultaneously maintained by the taxpayer for the same period, was noted in *Campbell* v. *Eastland*, 307 F.2d 478, 487 (5th Cir. 1962).

use one of its most effective civil investigative tools—*i.e.*, the summons procedure authorized by Section 7602 of the Code—once it refers the case to the Department of Justice for prosecution. See *United States* v. *LaSalle National Bank*, 437 U.S. 298 (1978); 26 U.S.C. 7602(c). Moreover, as the court below also noted (82-1452 Pet. App. 13a; 82-1509 Pet. App. 10a), cases involving false or fraudulent returns ordinarily place a far greater investigative burden on the Commissioner than other civil cases. That amended returns that purport to correct the original omissions may later be filed does not substantially reduce that investigative burden even though a thorough investigation may ultimately establish that the amended returns were not themselves fraudulent.[8]

3. While we believe the decision below is correct, we agree with the petitioners that there is a square conflict between this case and the Fifth Circuit's decision in *Nesmith*, on the one hand, and the Second and Tenth Circuits' decisions in *Britton* and *Dowell*, on the other. Moreover, the question is of considerable administrative importance. We are advised by the Internal Revenue Service that there are now 118 cases pending administratively with $11.8 million in taxes at stake, and 15 cases in litigation wih a total of $792,550 at issue. We agree that resolution of the conflict by this Court is therefore warranted.

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[8]Petitioner Deleet asserts (82-1509 Pet. 10-11) that the decision below "discourages the conscientious and repentant taxpayer" who has filed fraudulent returns from filing amended returns disclosing his true income. On the contrary, the decision is simply neutral in this regard, placing the taxpayer in neither a better nor worse position than he was before. At all events, as the court of appeals properly stated (82-1453 Pet. App. 11a; 82-1509 Pet. App. 8a), the relevant question is not whether it would be wise for Congress to create incentives for filing amended returns after fraudulent returns were filed, but rather, "whether Congress, in fact, did so."

CONCLUSION

The petitions for a writ of certiorari should be granted. The Court may wish to consolidate the cases.

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